

Message Text

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ACTION SS-14

INFO OCT-01 ISO-00 EUR-08 EB-03 SP-02 TRSE-00 NSC-05

NSCE-00 SSO-00 FRB-01 CIAE-00 ONY-00 /034 W

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TAGS: EFIN, UK

SUBJECT: SITUATION REPORT, DECEMBER 3

REF: (A) STATE 267168; (B) LONDON 19421

1. THE PRESS REPORTS THE UK WILL REPAY THE \$1.6 BILLION IT HAS DRAWN ON THE STANDBY FACILITIES NEXT THURSDAY, WHICH WILL REDUCE RESERVES TO \$3.5 BILLION, THEIR LOW-EST LEVEL FOR MORE THAN FIVE YEARS. (RESERVES STOOD AT \$5.16 BILLION AT THE BEGINNING OF DECEMBER; THEY ROSE BY \$453 MILLION DURING NOVEMBER -- BUT ONLY BECAUSE OF FOREIGN CURRENCY BORROWINGS BY PUBLIC CORPORATIONS AMOUNTING TO \$604 MILLION.)

2. THE CABINET HELD FURTHER DISCUSSIONS YESTERDAY ON THE LETTER OF APPLICATION FOR THE IMF LOAN (NOTE THAT THE BRITISH ARE, WE HEAR, SEEKING TO AVOID USE OF THE TERM "LETTER OF INTENT" BECAUSE THE TERM ITSELF REPORTEDLY PROVOKES HOSTILITY FROM SOME IN THE LEFT WING OF THE LABOR PARTY." JOEL BARNETT, CHIEF SECRETARY AT H.M. TREASURY, WAS AT YESTERDAY'S CABINET MEETING, WHICH IS AN INDICATION THAT THE CABINET WAS DISCUSSING CUTS IN PUBLIC SPENDING. AN INFORMED EMBASSY SOURCE

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SAYS THE CABINET AGREED YESTERDAY ON THE PROJECTED LEVEL

OF REDUCTION OF THE PUBLIC SECTOR BORROWING REQUIREMENT (PSBR) IT SHOULD PRESENT TO THE IMF. THE CABINET IS SCHEDULED TO MEET AGAIN ON MONDAY AND TUESDAY.

PETER JENKINS OF THE GUARDIAN, WHOSE SOURCES REACH INTO THE CABINET, SAYS IN A FRONT PAGE STORY THAT THE CABINET YESTERDAY AGREED IN PRINCIPLE TO REDUCE THE PSBR BY \$1.5 BILLION POUNDS. PUBLIC EXPENDITURE CUTS WOULD AMOUNT TO 1 BILLION POUNDS. THE REMAINING 500 MILLION POUNDS WOULD BE ACCOUNTED FOR BY WHAT JENKINS DESCRIBES ONLY AS "FINANCIAL TRANSACTIONS." ACCORDING TO JENKINS, NO TAX INCREASES ARE PLANNED.

THE PRESS DIFFERS ON PROSPECTIVE TIMING. THE TIMES SAYS THAT IT IS EXPECTED THAT AT THE MONDAY-TUESDAY CABINET MEETINGS DECISIONS WILL BE TAKEN FOR INCLUSION IN THE LETTER OF INTENT TO BE HANDED TO THE IMF REPRESENTATIVES, AND THAT HEALEY HOPES TO ANNOUNCE THE CABINET DECISIONS TO THE COMMONS THE WEEK OF DECEMBER 13. JENKINS SAYS A PACKAGE IS EXPECTED WITHIN A FORT-NIGHT BUT IT IS NOT CERTAIN THAT THE CABINET WILL BE ABLE TO DECIDE WHERE EXPENDITURE CUTS SHOULD FALL IN TIME FOR A PRE-CHRISTMAS PACKAGE.

3. THE PRIME MINISTER AND CBI LEADERS ARE MEETING TODAY TO DISCUSS THE ECONOMIC SITUATION.

4. DURING PARLIAMENTARY DEBATE LAST NIGHT OPPOSITION LEADER THATCHER CONTENDED THAT RISING LEVELS OF PUBLIC EXPENDITURE WERE A MAIN REASON FOR THE UK'S POOR

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INDUSTRIAL PERFORMANCE. PRIME MINISTER CALLAGHAN RE-TORTED THAT THE REASONS WHY COMPANIES DO NOT INVEST ARE MANY AND MANIFOLD AND GO FAR BEYOND THE PUBLIC SECTOR BORROWING REQUIREMENT. QUERIED ABOUT JOB CREATION OF THE KIND DEMANDED IN INDUSTRY THE PRIME MINISTER REPLIED THERE IS A GROWING STRUCTURAL PROBLEM WHICH AFFECTS NOT ONLY THE UK BUT THE WHOLE WESTERN WORLD.

WHEN QUESTIONED ABOUT HOW TO RESTORE CONFIDENCE IN STERLING AND BRING ABOUT STEADY REDUCTION IN THE BORROWING REQUIREMENT WITHOUT DEFLATING FURTHER AN ALREADY DEFLATED ECONOMY. THE PRIME MINISTER REPLIED THIS WAS INDEED THE PROBLEM FACING THE COUNTRY, I.E., THE NEED TO PROMOTE CONFIDENCE IN OVERSEAS HOLDERS OF STERLING WITHOUT AT THE SAME TIME DRIVING THE COUNTRY INTO A DOWNWARD SPIRAL. "I HOPE WE SHALL COME UP WITH THE RIGHT SOLUTION."

5. FOREIGN EXCHANGE AND FINANCE. BUSINESS IN THE FINANCIAL MARKETS IS THE SLOWEST IT HAS BEEN FOR OVER A YEAR. GILT PRICES WERE FOR THE MOST PART UNCHANGED. EQUITY PRICES MOVED VERY LITTLE AS WELL, THE FINANCIAL TIMES INDEX OF 30 ORDINARY INDUSTRIALS BARELY MOVING FROM THURSDAY'S CLOSE OF 301.2 TO FRIDAY'S 300.9.

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A SMALL WAVE OF BUYING LIFTED STERLING TO OVER \$1.67 ON THURSDAY MORNING. THIS HAS BEEN ATTRIBUTED TO THE COMMENT BY LEN MURRAY, SECRETARY GENERAL OF THE TUC, THAT HE WOULD ACT REASONABLY IF THE GOVERNMENT DID. HOWEVER AMBIGUOUS THE REMARK, TRADERS IN THE FAR EAST INCREASED THEIR STERLING DEMAND AND THE HIGHER RATE ESTABLISHED THERE CARRIED INTO EARLY MORNING LONDON TRADING. BY NOON THE RATE HAD RETURNED TO THE WEDNESDAY LEVELS AND THE POUND CLOSED AT \$1.6645, UP 0.0015 CENTS ON THE DAY. ON FRIDAY THE POUND OPENED AT \$1.6635.

ARMSTRONG

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